TAXATION AND THE MUNICIPAL BUDGET

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The relation of the revenue side of municipal finance to budget administration is a subject that has not attracted a great amount of public attention. The development of the municipal budget in American cities during the last few years has been almost wholly in the direction of a more effective control of expenditures. In fact, the term "budget" is generally used to refer solely to a more or less detailed estimate of future expenditures. The fact is lost sight of that the budget properly includes an estimate of probable income as well as of outgo. This failure to recognize the full meaning of the budget has been due, in part, to the circumstance that frequently the administration of the revenue-raising function has been in the hands of a set of officials entirely distinct from those charged with the duty of supervising expenditures. Moreover, in many cases the tax ordinance is passed at a time so far distant from the time when future expenditures are determined that it is difficult to associate the two acts as part of the same procedure—the passing of the budget. Finally, American cities have been given so little independent authority in regard to the objects and methods of local taxation that the process of raising revenue to meet estimated needs has been largely reduced to the formal administration of a previously enacted law or constitutional provision. The revenue system has not been open to substantial improvement through local action, and has, therefore, lost its position as a complementary element in the development of budget administration.

The fact remains, however, that the nature of the revenue system may have an important bearing upon the effective carrying out of a scientific budget plan. From the standpoint of successful budget administration a good revenue system should possess at least two salient characteristics—ready adaptability to changing demands for revenue, and certainty and regularity of yield.

Unless the revenues can be adjusted to meet the estimated ex-

penditures without causing serious disturbance in the economic and social organization of the community, the city administration may be handicapped in putting into effect a constructive budget program. Municipal expenditures are steadily increasing. This increase must be met by a corresponding increase in revenues. The revenue system should be so adjusted to take care of the necessary annual increase with the least strain on the tax-paying public.

Certainty is as important as flexibility. If it is not possible to estimate with reasonable accuracy the amounts that the various sources of revenue will yield during the coming year, it will obviously not be possible to construct and carry out an intelligent plan of expenditure. There should be no marked fluctuations in the amount of income from year to year, or at least no fluctuations not due to readily foreseen and assignable causes.

The following brief discussion will deal exclusively with these two characteristics of American municipal revenues—flexibility and certainty of yield—consciously omitting all considerations of a more fundamental nature touching the substantial justice of taxation.

I. Adaptability to Revenue Demands

Theoretically, the administration of the budget calls for a revenue system composed of certain main sources which are relatively stable and dependable, and which do not require adjustment or change from year to year. Additional revenues should be obtained, as needed, by adjusting the rate of return from minor sources. In this way, conceivably, revenue increases could be made possible with little or no disturbance of existing conditions. As a general thing, municipal expenditures do not increase from year to year at a rate exceeding 10 per cent. In theory, the most satisfactory way of handling such an increase would be to increase the yield of one or more of the less important sources of income without tampering with the principal source.

In American practice no such rule is followed. Up to the present time cities have been depending largely upon increasing the returns from the general property tax, either by raising the rate, or, if that was not legally possible, by raising the basis of assessment to some point nearer the true valuation. Other sources of revenue are only occasionally considered as available to meet the requirements for more money. In fact, it is only when the general property rate has been increased to the legal limit, and the basis of assess-

ment raised to 100 per cent, that the cities begin to look around for other sources of additional revenue. The city is thought to be in rather desperate financial straits when the administration is forced to consider anything but the general property tax as a means of raising more revenue.

The general property tax, which is thus made the principal equalizing element in the revenue system, is, at the same time, the main dependence of American cities. Taking the cities of the country as a whole, the general property tax produces over 60 per cent of the annual municipal revenue. As the tax is administered in most cities, it amounts practically to a tax upon real property, since the yield from the personal property tax constitutes a small and decreasing proportion of the total income. The result is that the owners of real property, paying more than half of the total income of the city, bear in the first instance the direct burden of every increase in expenditure. In most large cities the land-owning population constitutes from a sixth to a third of the voting population. The number of real property taxpayers is, therefore, relatively small. The burden of increased budgets thus falls upon a small element in the community, who, because they contribute so largely to the financial support of the city, not unnaturally feel that they are being unjustly treated.

Moreover, in most cities the real estate fraternity is strongly and compactly organized, and consequently in a position to hamper plans for administrative development that call for added expenditures. Taxpayers' organizations which undertake to criticise the work of city administrations perform a useful public service. But when the sole standard by which the acts of the local government are judged is the amount of immediate expenditure that will be involved, the result is likely to be mere obstruction, regardless of ultimate public benefit. It is highly desirable that an administration, on extravagance bent, should be effectively checked, but, by the same token, the administration that is sincerely attempting to promote the best interests of the community should not be hindered and restrained through fear of arousing the taxpayers' ire by reason of an increased tax rate. The fact that practically every American administration is subjected to just this fear is due, in part at any rate, to a lack of flexibility in the revenue system. It does not respond properly to legitimate demands for expansion.

The remedy is easily effected—on paper. It is only necessary to establish the general property tax at a flat rate, which could be retained year after year without change. Increased revenue from the general property tax would then arise only through an increased property valuation. The needed increased revenue from year to year could be obtained by increasing the rate of some other tax, or by levying a tax upon some new class of objects. In this way the real property owners would be able to estimate for a reasonable period of time in advance exactly what their contribution to the public treasury would amount to. They would not be subjected to the harrowing experience of discovering each year that the tax rate had been raised, and that they were required to shoulder an even larger share of the city's financial burdens. The constricting influence of the property owners on the plans of the administration would be somewhat lessened, and an elasticity given to the city's finances that would open the way for constructive programs of public improvement that would be of lasting benefit to the community.

Given complete local autonomy in matters of finance, a program similar to the one suggested above might be practicable. The general property rate could be fixed at some point near the customary rate, and held there during a period of years. The problem of raising needed additional revenue would then probably have to be solved by the imposition of some new tax. There is no tax or source of revenue, other than the general property tax, in the systems of most American cities that lends itself readily to annual adjustment and manipulation in the interests of additional income. The most important sources of revenue, aside from the property tax, are the proceeds of special assessments and the earnings of public service enterprises. Naturally the latter consist chiefly of the income from water rents, and this revenue is in most instances devoted directly to the support and extension of the water supply system, or in other ways sequestered, and not available for general purposes. Special assessments, from the nature of the case, expand and contract as the need for them demands, and cannot be considered as part of the general revenue system. Taxes other than the general property tax, usually various license and business taxes, are not wholly adaptable to the purpose of annual adjustment, because it does not necessarily follow that an increased rate

will result in increased revenue. Moreover, in a considerable number of instances, the chief of these special taxes, the liquor tax, is imposed by the state, and the administration of the tax is either in the hands of state agents, or directly under the control of the state legislature. State subventions and grants are, of course, wholly out of the question. The other sources of municipal revenue yield such a trifling proportion of the total income that they could not be used successfully to produce the required amounts of additional revenue.

It is not possible within the limits of this discussion to consider all the possible new sources of city revenue. It is suggested, however, that as an equalizing element in the construction of the revenue side of the budget, a local income tax would be probably as satisfactory as any other. From the restricted viewpoint of budget administration, the income tax would prove an admirable balance-wheel. It would not be necessary to use the tax to raise large sums. It would be resorted to only for the excess revenue not provided for in other ways. The tax would probably never have to produce over 10 per cent of the total revenue. For this reason a rate could be fixed so low that it would not be a serious burden to anyone. At the same time the exemption limit could be placed sufficiently low to include a considerable proportion of the income-earning population, so that the burden of a slight increase in the rate from year to year could be distributed among a comparatively large number of persons. A change in the rate of a tax such as the income tax could be depended upon to bring about a corresponding change in the revenue derived. Moreover, a change could be effected without seriously upsetting the established economic and social order. These considerations commend the adoption of the income tax to provide the needed element of flexibility in the local revenue system.

It is recognized, of course, that the adoption of the income tax, or for that matter of any other new source of revenue, as a generally accepted element in American municipal finance is hardly practicable. The chief obstacle is found in the legal fetters that bind the cities in matters of finance. An objection fully as powerful, as far as an income tax is concerned, lies in the fact that the American public is not prepared to accept the income tax as a proper source of municipal revenue. The proposal for a municipal income tax is

therefore not offered as an immediately practical solution of the present illogical practice of calling upon the general property tax for every needed increase in revenue. However, it is doubtless a fact that this practice is the only thing that can be done with conditions as they actually exist. But this does not change the fact that the system is illogical, nor necessarily act as a bar to the consideration of possible remedies.

II. Certainty of Yield

The second important characteristic of a good tax or source of revenue from the standpoint of the budget is certainty of yield. The budget is an estimate of expenditures, and an estimate of revenues. If these estimates, either on the side of income or outgo, are not borne out by future results the budget system will fail, since the city administration will be burdened with financial embarrassments which it is the function of the budget to obviate. It is, therefore, of great importance that estimated revenues actually accrue.

In formulating the basis for an estimate, the most dependable indicator is past experience. If the income from a certain source has, in the past, been steady and regular, it is fairly safe to assume that it will remain so, and that the amounts realized in past years can be counted on for the future. The same confidence could be reposed in the estimate if there had been a reasonably steady increase or decrease, or if past fluctuations could be traced to causes the future operation of which could be foreseen. In this connection, it may be worth while to examine in more detail some of the more important sources of municipal revenue, actual or possible, in regard to their adaptability to an accurate estimate of future results.

1. The General Property Tax. In the strict sense of the word, the revenue from the general property tax is not estimated in American municipal budgets. The income from all other sources is estimated, and it is then assumed that the property tax will yield the necessary amount to make up the remainder. Thus, when it is determined how much can be expected from other sources, the remainder is divided by the total property valuation, and the resulting tax rate imposed. The revenue budget is then complete, on the assumption that the property tax yield will be 100 per cent of the levy.

In the case of the tax on real property, this assumption is not wholly unjustified. For reasons that it is not necessary to consider here, it is the usual experience that a large proportion of the real property tax is actually collected during the year of the levy, or is collectible soon after. The experience of the city of New York may be cited as an illustration of the relative certainty of the revenue from the real property tax. The following statement shows, for the period of five years, 1909 to 1913 inclusive, the percentage of the original levy remaining uncollected at the end of 1913, the percentage that had been written off on account of discounts, cancellations, or deductions, and the percentage of the net collections:[1]

	Percentage of		
	Uncollected balance	Deficiencies written off	Net collections
1909	1.16	2.99	95.85
1910	3.08	1.83	95.09
1911	4.09	1.30	94.61
1912	5.60	0.86	93.54
1913	15.18	0.93	83.89

These figures indicate quite a remarkable stability of yield. The average percentage of net collections to total levies for the four years previous to 1913 was, at the end of that year, almost 95. There is, of course, a steady decline as the final date is neared, but the difference between 1909 and 1912 was only 2.31 per cent. There is a sharp falling off in 1913, but it should be borne in mind that the second half of the property tax is not due till November 1, and to have collected over 80 per cent two months after the last installment was due is not a bad record.

The experience recorded above is fairly typical, and upon this evidence may be based the general conclusion that the real property tax is fairly satisfactory from the standpoint of an accurate forecast of future results.

[1] Figures taken from report of Department of Finance and Bureau of Municipal Research, New York, 1915, on *Revenues and Expenditures, 1910 to 1914*, inclusive. Page 222.

As has been pointed out many times elsewhere, the personal property tax is not a satisfactory tax as regards the budget estimates. Whatever certainty there may be in relation to this tax is a certainty that it will not produce as much as the levy calls for. Properly speaking, an estimate of the yield would be in effect an estimate of how great the deficiency would be. It has universally proved practically impossible to collect a respectable percentage of the total levy. In this connection, the experience of New York is interesting, though not wholly typical. New York exempts large classes of personal property which, if an attempt were made to levy and collect taxes on them, would materially increase the percentage of the deficiencies. As a general indication, however, figures similar to those just cited for the real property tax are given here for the personal property tax:[2]

	Percentage of		
	Uncollected balance	Deficiencies written off	Net collections
1909	31.96	7.31	60.73
1910	22.43	7.47	70.10
1911	23.67	5.51	70.82
1912	29.23	0.96	69.81
1913	35.30	0.65	64.05

These figures show that for the three middle years, 1910–1912, there was a fairly consistent collection of about 70 per cent of the levy. The year 1909 was a poor year, with only 60 per cent collected five years after the levy had been made. But the results seem to show that 70 per cent is about all that can be expected. If this assumption should be made, and the inevitable deficiency made up in some other way each year, the results might not be so serious. But as a matter of fact, it is assumed each year that the whole amount will be collected, and the uncollected balance is either added to some later budget or made up by the issuance of bonds. The combined real and personal tax deficiency in the city of New York for the years 1899 to 1913, inclusive, was $77,478,043.99. Of this total, $41,259,855.04, or 53.2 per cent, was personal tax deficiency, in spite

[2] *Op. cit.*

of the fact that the total personal levy for the same period was only 8.4 per cent of the total levy, for personal and real property combined. These facts serve to emphasize the fact that in comparison with the real property tax the personal property tax is an undesirable tax when considered in relation to budget administration because of the uncertainty of the yield and the difficulty of collection.

2. Other Revenues. Of the other sources of revenue resorted to by American cities, special assessments and state subventions may be dismissed without comment. The only other important revenue, from the point of view of the amount of the yield, is the revenue of the water supply system, and other public service enterprises. In regard to these revenues, it should be noted that only in exceptional instances do they yield a real income to the city, over and above the actual cost of carrying on the enterprises. It is, nevertheless, necessary and important that the income from these sources be accurately estimated. As a matter of fact, there should be no serious difficulty about this. Once an enterprise is firmly established it should be possible to estimate the revenue from it with a sufficient degree of accuracy for all practical purposes. The income from water rents, for instance, is steady and dependable. To be sure, the early financial officers of New York made serious miscalculations in regard to this revenue when they diverted it in perpetuity to the support of the sinking funds, with the result that enormous amounts of money have been and are being tied up, and have only recently been released by a virtual evasion of the law. Such an error, however, was due directly to lack of experience, and would not have resulted seriously had it been possible to correct it when the actual situation was realized. Once a basis of experience is established, there is nothing inherently difficult in estimating the probable revenue from any public service enterprise. The volume of business is not subject to marked fluctuations on account of economic conditions, the gross revenue can be forecast without difficulty, the costs of operation soon become standardized, and the net revenue is therefore easily deducible.

The importance of the various minor municipal revenues does not warrant an extended discussion. It may be interesting, however, to review the experience of the three years, 1912 to 1914 inclusive, in New York with certain of the more important of the minor revenues of that city. The revenues included are the bank

tax, mortgage taxes, county clerk's fees, county register's fees, and interest from overdue taxes. The following table shows the amounts estimated at the beginning of each year compared with the amounts actually collected during that year for each of the sources of revenue:

		Bank tax		Mortgage taxes		County clerk's fees	
		Total	Per cent difference	Total	Per cent difference	Total	Per cent difference
	Estimated Revenue...	$3,500,000.00		$1,200,000.00		$120,000.00	
1912	Collected Revenue ...	3,489,313.67		1,290,479.75		131,387.80	
	Difference.........	− 10,686.33	0.3	+ 90,479.75	7.5	+ 11,387.80	9.5
	Estimated Revenue...	3,400,000.00		1,100,000.00		205,000.00	
1913	Collected Revenue....	3,600,728.73		1,518,694.77		197,202.98	
	Difference.........	+ 200,728.73	5.9	+ 418,694.77	38.1	− 7,797.02	3.8
	Estimated Revenue...	3,500,000.00		1,000,000.00		190,000.00	
1914	Collected Revenue....	3,629,408.92		1,130,545.28		200,559.36	
	Difference.........	+ 129,408.92	3.7	+ 130,545.28	13.1	+ 10,559.36	5.6

		County register's fees		Interest on overdue taxes	
		Total	Per cent difference	Total	Per cent difference
	Estimated Revenue..................	$310,000.00		$1,600,000.00	
1912	Collected Revenue..................	310,279.90		1,967,473.34	
	Difference........................	+ 279.90	0.1	+ 367,473.34	23.0
	Estimated Revenue..................	305,000.00		1,700,000.00	
1913	Collected Revenue..................	286,887.76		2,703,489.91	
	Difference........................	− 18,112.24	5.9	+1,003,489.91	59.0
	Estimated Revenue..................	300,000.00		2,300,000.00	
1914	Collected Revenue..................	270,854.97		1,819,587.19	
	Difference........................	− 29,145.03	9.7	− 480,412.81	20.9

The greatest percentage of variation from the estimate appears in the cases of the mortgage tax and the revenue from interest on overdue taxes. The yield of both of these sources showed rather marked fluctuations from year to year, as might have been expected, since they both depend, in a measure, upon general business and economic conditions. In the case of the other taxes and revenues,

the percentage of difference between the estimate and the yield was never greater than 10 per cent. The returns from the bank tax and the register's fees were regular and fairly dependable, the former steadily increasing, and the latter steadily decreasing.

It is interesting to note the apparent effect of each year's experience upon the estimate for the next year. In the case of the interest returns, for instance, the large excess of receipts over the estimate in 1913 (59.0 per cent), was doubtless in part responsible for the increased estimate in 1914, which, coupled with a sharp falling off in receipts made a deficiency of over 20 per cent. This is an excellent illustration of the difficulty with an uncertain revenue. If the estimate for 1913 had been continued in 1914 the results would have been much more satisfactory. But there was no certain way of predicting the marked decline in returns in 1914, and the estimate was a guess, based in part on 1913 results, which did not materialize the next year.

The results with the bank tax were more satisfactory. In 1912 the yield was a trifle below the estimate. The estimate in 1913 was reduced by $100,000. At the same time the collections increased so that there was an excess of over $200,000. This experience justified a return in 1914 to the 1912 estimate, and the tax, not being subject to violent fluctuations, continued to yield more than $100,000 in excess of the estimate.

As a general rule, it is probably better to have the results exceed the estimates, as a whole, than to have an appreciable deficiency. But the margin between estimates and collections should not be great in either direction. Moreover, the discrepancy need not be great with a properly constructed tax system. The operation of a tax should not be uncertain. If a large deficit is created by reason of the failure of certain sources of revenue, it must be made up, frequently by issuing bonds, to the detriment of future taxpayers. On the other hand, a substantial surplus may lead to extravagance. In actual practice, however, as in the case of New York, a general surplus in any one year would be applied to the reduction of taxes for the following year, so that there would be no danger of an accumulating surplus. Moreover, as a matter of fact, the difference between estimated expenditures and revenues and actual expenditures and revenues is not sufficiently great in any one year to cause serious embarrassment. As has been noted, however, the cumu-

lative deficiencies in the collection of the general property tax has, in New York, required the resort to long term bonds to cover at least part of the loss.

It is fair to conclude that the revenue systems of American cities, as a general rule, have proved more satisfactory from the standpoint of certainty of return, than from that of flexibility. The typical municipal revenue system needs the greater flexibility which might be obtained by the introduction of some form of taxation the rate of which might be varied from year to year without causing either great economic disturbance, or widespread popular opposition. On the other hand, the real property tax, the backbone of the system, has proved reasonably satisfactory with regard to the sureness with which results can be counted on, and the various minor revenues can be forecast with sufficient accuracy to avoid serious discrepancies between budget estimates and actual collections.